No. 79-1266

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

CHARLES W. STEADMAN,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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PETITIONER'S SUPPLEMENTAL APPENDIX

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March 1980

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 13695 / June 29, 1977

INVESTMENT COMPANY ACT OF 1940
Rel. No. 9830 / June 29, 1977

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 593 / June 29, 1977

Admin. Proc. File No. 3-3101

In the Matter of

STEADMAN SECURITY CORPORATION
1730 K Street, N.W.
Washington, D.C.
(801-8141)

CHARLES W. STEADMAN

REPUBLIC SECURITIES CORPORATION
(8-13223)

STEADMAN INVESTMENT SERVICES CORPORATION
(8-14704 and 801-5679)

THE STEADMAN CORPORATION OF AMERICA
(8-13995)

ABERDEEN MANAGEMENT CORPORATION
(8-1867)

OPINION OF THE COMMISSION

BROKER-DEALER AND INVESTMENT ADVISER PROCEEDINGS

Grounds for Remedial Action

Fraud

Late Filings

Receipt of Illicit Compensation from Registered Investment Companies by their Investment Adviser

Where an investment company complex's controlling person concealed material facts from investors, caused the entities that he controlled to breach their reporting obligations to the Commission, and also caused a registered investment adviser, all of whose voting stock he owned, to accept compensation from two of its advisee-investment companies that was not described in the advisory contracts, held, in public interest to bar that person from association with any investment adviser, to prohibit him permanently from serving or acting in any of the capacities enumerated in Section 9(b) of the Investment Company Act, and to suspend

him from association with any broker or dealer for 12 months. But order's effective date stayed for 90 days to facilitate an orderly transition in the management of the affected investment companies and to give the barred individual an opportunity to dispose of his controlling interest in the advisory organization.

Fraudulent Omissions to Disclose Material Facts

Bank Loans

Bank Deposits

Checking Accounts

Certificates of Deposit

Causal Relationships -- Significance of

Management -- Character of

Materiality

Willfulness

State of Mind

Intent to Defraud

Scienter

Applicability of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), to Administrative Proceedings

Applicability of Ernst & Ernst v. Hochfelder, supra, to cases arising under the Investment Company and Investment Advisers Acts

Investment company manager's concealment of his heavy borrowings from the very same banks in which he caused the investment companies to deposit large sums in non-interest bearing accounts, held, fraudulent and hence in willful violation of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, Rule 10b-5 under the latter section, Sections 206(1) and 206(2) of the Investment Advisers Act, Section 20(a) of the Investment Company Act and the Commission's rules thereunder, and also Sections 30 and 34(b) of the Investment

Company Act as well as the Commission's rules under the last two sections.

Investment company manager's heavy borrowings from the banks in which he caused his investment company clients to keep their cash, held, material to investors even in the absence of a causal link between the loans to the manager and the investment companies' deposits because "reasonable investors could reasonably have deemed the relationships corrupting."

A failure to disclose material facts by one charged with the duty to do so is willful even in the absence of intent to defraud.

Proof of intent to defraud, held, unnecessary in administrative proceedings under the Securities Exchange, Investment Company, and Investment Advisers Act. Scienter requirements of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), held, inapplicable to administrative proceedings initiated by the Commission.

Though relevant to administrative proceedings initiated by the Commission, scienter has no bearing on the willful violation issues in them. It goes only to the sanction question.

Advisory Contracts -- Advisory Compensation

Investment Company Managers -- Compensation

Interest-Bearing Loans and Extensions of Credit

Advisory Fees -- Overpayments of

Refunds -- Failure to Make when Due

Money -- Use of as Compensation

Brokerage -- As Compensation

Sections 15(a)(1) and 17(e)(1) of the Investment Company Act Construed

Advisory Contracts -- Requirements that all Compensation to be Paid Thereunder be Described

Where an investment company manager borrowed substantial sums, on which he paid interest, from the banks in which the investment companies kept their cash, held, such loans

were "compensation" to the manager. But they were not "compensation" for purposes of Section 15(a)(1) of the Investment Company Act. The only compensation that counts for purposes of Section 15(a)(1) is compensation paid by the investment company itself. On the other hand, such compensation does fall within the prohibitions of Section 17(e)(1) because that section reaches any compensation from any source.

Portfolio brokerage business at customary rates of commission obtained by investment adviser from the commercial banks in which his investment companies kept substantial sums on deposit, held, compensation to the adviser.

Loans and portfolio brokerage business obtained by an investment adviser to investment companies from the banks in which those companies kept substantial deposits, held, compensation to the adviser -- but not prohibited by Section 17(e)(1) of the Investment Company Act because neither purchases nor sales of the investment companies' property were involved. Checking accounts involve the rendition of services by the bank. No "property" interests are bought or sold.

A certificate of deposit issued by a commercial bank is "property" for purposes of Section 17(e)(1) of the Investment Company Act. But adverse findings, based on the purchase of such a certificate by a registered investment company whose investment adviser borrowed from the issuing bank, withheld, where causal connection between the investment company's purchase of the certificate and the issuing bank's loan to the investment adviser unclear.

Where registered investment companies overpaid their advisory fees, where the adviser did not refund such excess in toto as soon as the requisite computations were made but did so in monthly installments with interest at a rate appreciably below the then prevailing prime rate, and where such arrangements were not described in the advisory contracts, held, arrangements were in willful violation of Section 15(a)(1) of the Investment Company Act.

An investment adviser who uses money that belongs to his investment company client receives "compensation" from that client.

A bargain rate of interest is "compensation" moving from the recipient of such interest to the party paying it.

Joint or Joint and Several Participants

Combinations

Section 17(d) of the Investment Company Act Construed

Absent a finding of a causal nexus between the loans to the adviser and the deposits by the investment companies, a showing that an investment adviser borrowed money from the banks in which his investment company clients kept large sums on deposit, held, insufficient to establish a joint participation between the adviser, on the one hand, and the investment companies, on the other, for purposes of Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder.

Section 17(d) of the Investment Company Act does not reach every economic relationship in which a registered investment company is on one side and one of its affiliates on the other.

Some element of combination must be shown in order to bring Section 17(d) of the Investment Company Act to bear on a particular situation. If there is such a combination, the section applies even though the investment company is not a conscious participant.

Tender Solicitation Fees

Section 17(e)(1) of the Investment Company Act Construed

First Multifund of America, Inc., 44 S.E.C. 680 (1971), Distinguished

Where investment adviser to registered investment companies retained tender solicitation fees received from tender offerors who wanted to purchase and did purchase securities owned by the investment companies and did so without performing any necessary brokerage services, held, willful violation of Section 17(e)(1) of the Investment Company Act, which prohibits persons affiliated with registered investment companies from accepting any compensation (other than a regular salary or wages from the company) for the purchase or sale of any property to or for the company, except in the course of such person's business as an underwriter or broker.

Where an investment company needs no brokerage service, its affiliated person is precluded from collecting any brokerage fee.

One who receives an advisory fee from an investment company in return for his services

in formulating the company's investment decisions cannot pocket a second fee for the very same service by posing as a broker. In First Multifund of America, Inc., 44 S.E.C. 680 (1971), the investment company needed brokerage services in order to achieve its objective. Hence the affiliated broker was held entitled to compensation. In the tender offer situation on the other hand, the investment company needs no broker.

Late Filings

Public Interest Implications

Egregiously late filings of an investment company complex's required reports have grave public interest implications.

Investment Company Complexes -- Intercompany Transactions

Foreign Unregistered Investment Companies-Transactions with Affiliated Domestic Registered Investment Companies

Section 17(a) of the Investment Company Act Construed

Where a foreign unregistered investment company bought securities from and sold them to domestic registered companies that were under common control with it, held, transactions were in willful violation of Section 17(a) of the Investment Company Act.

Section 17(a) of the Investment Company Act prohibits members of an investment company complex from swapping securities with each other.

Where transactions in securities among members of an investment company complex were in willful violation of Section 17(a) of the Investment Company Act and where no exemption was available under the Commission's Rule 17a-7, because one of the companies involved was not registered under the Act, held, exemptive order should have been applied for and failure to seek it cannot be condoned. Nevertheless, such violations are of little weight in assessing sanctions because of their somewhat technical character, because there was no showing that violative conduct inflicted any harm and because they saved investors substantial brokerage commissions.

Control

Investment Companies -- Sole Investment Discretion

Investment Advisers to Investment Companies -- Nature of the Relationship

Independent Contractors

Stock Ownership

Section 2(a)(9) of the Investment Company Act Construed

Where an investment adviser to an unregistered foreign investment company had sole investment discretion with respect to its portfolio, held, the adviser controlled the company for purposes of Section 2(a)(9) of the Investment Company Act.

Control of an investment company's portfolio is control of the company itself.

An investment company's investment adviser is almost always in control of his investment company client. That is so even where he owns none of the investment company's stock and even where

ultimate control is in the hands of others. The adviser's controlling influence over his advisee does not stem from stock ownership. It stems from the fact that he manages the advisee's affairs and is normally the only audible voice in its management.

An investment adviser is an independent contractor. Hence his position with the advisee is not an "official position" for purposes of Section 2(a)(9) of the Investment Company Act.

Evidence

Standard of Proof

A preponderance of the evidence is sufficient to establish the truth of an allegation in an administrative proceeding under the federal securities statutes.

Public Interest

Dominant Individuals and their Corporate Instrumentalities

Corporate Respondents with Innocent Non-voting Shareholders

Sanctions -- Withholding of

Jurisdiction -- Reservation of

Where an investment advisory organization's misconduct was extremely serious, held, organization's controlling person and sole voting shareholder barred from association with any investment adviser, permanently prohibited from any association with any registered investment company in any of the capacities enumerated in Section 9(b) of the Investment Company Act, and suspended for 12 months from association with any broker or dealer. But sanctions on the corporate respondents controlled by that person, withheld, in the Commission's discretion because of the lack of any pressing need for such sanctions, because corporate respondents had innocent non-voting shareholders, because putting the corporate respondents out of business at once would leave the controlling person with nothing to sell which would be inconsistent with the Commission's decision to give the individual wrongdoer an opportunity to dispose of his interest, and because Commission wished to give corporate respondents an adequate opportunity to liberate themselves from the wrongdoer's controlling influence.

But jurisdiction reserved to impose appropriate sanctions on corporate respondents, should they fail to make required showing of liberation within the 90 days allotted for that purpose.

Breach of Fiduciary Duty Involving Personal Misconduct -- Cognizability of in Administrative Proceedings

Section 36(a) of the Investment Company Act Construed

Section 36(a) of the Investment Company Act is a grant of jurisdiction to the federal courts. Hence that section cannot serve as the sole basis for an administrative proceeding. But that section is pertinent to the assessment of sanctions in administrative proceedings otherwise properly before the Commission.

Where the record in an administrative proceeding with respect to an investment company manager showed that he had willfully violated significant substantive provisions of the securities statutes and also showed that those willful violations entailed breaches of "fiduciary duty involving personal misconduct," held, the breach of duty element is germane in fixing the quantum of remedial action.

Bar Orders

Disqualifications

Orders of Permanent Prohibition under Section 9(b) of the Investment Company Act

Stays

Bar orders normally become effective on issuance. But when appeals to the Court of Appeals are taken or about to be taken, the Commission gives stays of sufficient duration to permit applications for further stays to the Court of Appeals.

Where a bar order issued against the operating head of an investment company management organization, held, effectiveness of bar stayed for 90 days to give investment companies' directors adequate opportunity to make appropriate arrangements for the companies' future and to give the barred individual an opportunity to dispose of his controlling interest in the advisory organization.

The Commission always retains control over its own orders. Inherent in the power to impose

disqualifications is the power to lift or modify those disqualifications.

Constitutional Law

Ex-Post-Facto Laws

Statutory Construction

Changes in Remedies -- Retrospective Application of Continuing Wrongs

Section 9(b) of the Investment Company Act Construed

Section 203(f) of the Investment Advisers Act Construed

Remedies added to the Investment Company and Investment Advisers Act by amendments to those statutes that become effective on December 14, 1970, held, available in a case involving misconduct some of which occurred before that date because the statutory changes in question went solely to matters of remedy and had no bearing on legal rights or legal duties and because much of the misconduct occurred after the amendments had become law.

Constitution's ban on ex-post-facto laws, held, inapplicable to the retrospective application of tests of fitness in licensing statutes.

APPEARANCES:

Peter J. Nickles, of Covington & Burling, for respondents.

Vernon J. Vander Weide and Michael A. Starr, of the Washington Regional Office, for the Division of Enforcement of the Commission.

James C. Meers, of Corcoran, Youngman & Rowe, for certain investment company directors.

David Silver and Matthew P. Fink, for the Investment Company Institute.

I. INTRODUCTION

Charles W. Steadman, an investment company manager, and five corporations that he heads 1/ appeal from an administrative law

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1/ All five are registered with us. Some are registered as investment advisers. Others are registered as brokers and dealers.

judge's initial decision adverse to them. 2/ The principal corporate respondent is Steadman Security Corporation ("SSC"). Steadman owns all of SSC's voting stock. And SSC owns all of the stock of the other corporate respondents. Through SSC and SSC's subsidiaries, Steadman manages a group of mutual funds. During the relevant period, that group consisted of:

Steadman American Industry Fund, Inc.
Steadman Science and Growth Fund, Inc.

2/ Our Division of Enforcement is satisfied in the main with the initial decision. However, it too appeals. Its appeal brings up for review the correctness of the administrative law judge's refusal to make some of the findings of violation for which the Division asks. Leave to be heard was granted to certain directors of the Steadman-managed investment companies. Such leave was also granted to the Investment Company Institute. Briefs were filed, and oral argument heard. Our findings are based on an independent review of the record.

Steadman Fiduciary Investment
Fund, Inc.
Consumers Investment Fund, Inc.
Associated Fund Trust
Aberdeen Fund

The size of the asset pool under Steadman's management grew dramatically during the 1960's. At its height Steadman's investment advisory organization had some $250 million under management. Much of this growth came from acquisitions. Other investment advisers were bought up. The requisite capital was raised in the main by borrowing from commercial banks. The banks from which Steadman and SSC borrowed were also the banks in which the Steadman-managed funds kept their cash.

These complex and protracted proceedings present many issues. We begin with those that arise out of the banking relationships to which we have just referred.

II. BANKING RELATIONSHIPS

By reason of his predominant role in the management of the funds, Steadman was in a position to choose the banks in which they kept their

cash and to determine the amounts that would be kept on deposit in checking accounts that paid no interest. 3/

3/ Section 17(f) of the Investment Company Act requires an investment company of the management type to place its securities and similar investments in the custody of a bank, a stock exchange member or itself. If a bank is selected as custodian, the present law requires the investment company to keep all its cash assets in such bank (subject to certain exceptions). Although not required during the period relevant to this case, it was Steadman's practice to keep the funds' cash assets in the custodian bank. This practice had been recommended in our report on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess., 336 (1966). The terms "cash assets" includes, for example, the proceeds from the sale of portfolio securities, interest and dividends derived from portfolio securities and any judgments realized by the investment company. Checking accounts are used principally for dividend distributions to fund shareholders, redemptions, and current expenses.

Starting in December 1965, Steadman and SSC began borrowing from the Washington bank in which the Steadman Funds then kept their checking accounts. By mid-1968, Steadman himself owed that bank over $1 million, and SSC, although it had repaid its loans, had borrowed up to $200,000. During those two and a half years, Steadman asked the bank to direct at least $50,000 of that bank's portfolio brokerage business to SSC's broker-dealer subsidiary, Republic Securities Corporation. And Republic, a relatively small, unseasoned firm, actually got $25,000 a year in brokerage from the bank.

To expand the pool of assets under his management, Steadman arranged to have SSC buy two more investment advisory organizations. To finance these purchases, he asked the bank to lend SSC $2 million on an unsecured basis. But it turned him down, finding inadequate assurance that SSC, whose operations had thus far been unprofitable, would be able to repay. Only after retaining two prominent investment bankers to locate a receptive bank did Steadman find a New York bank willing to grant SSC the loan.

At about the time that the loan was agreed to, Steadman and SSC recommended to the directors of the three mutual funds for which SSC was investment adviser that those funds transfer their bank accounts to the New York bank which was lending the money. The directors were told that the New York bank's custodial fees were lower than those of the Washington bank. The services that the New York bank was capable of supplying were also lauded. But no mention of the loans was made. The funds' boards knew nothing at all about them when they approved the transfer. 4/

Bereft of the funds' accounts, the Washington bank called its loans to Steadman. Steadman succeeded in getting a second Washington bank to lend him enough to repay the first. But by 1970, the market value of the collateral securing that loan had fallen materially. So this second Washington bank called its loan. Steadman got a 90-day extension. Two days later,

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4/ When Steadman moved his banking business to New York, he asked the bank there to give Republic some brokerage to make up for the lost income from the Washington bank. But the New York bank gave Republic very little business.

one of the funds bought a 90-day certificate of deposit from that bank in an amount in excess of the loan.

Faced with the need to repay the second bank's loan at the end of 90 days, and also confronted by problems in meeting SSC's obligations on the larger loan from the New York bank, Steadman and SSC sought out yet another Washington bank which would lend them enough to cover both loans, that is, over $4 million. All they got was enough to pay off the loan from the second Washington bank. Shortly thereafter, this third Washington bank received the account of a Steadman-managed fund whose account had been in St. Louis. Again, that fund's board was not told about the loan when it approved the transfer. 5/

Steadman said nothing about his or SSC's loans in any of the materials sent to the funds' actual or prospective shareholders. Nor did any report filed with us even hint

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5/ A week before the board met, Steadman whote to the St. Louis bank requesting it to waive its notice period and to send its records to the designated Washington bank.

at the loans. Yet it would, we think, have been obvious to anyone (let alone someone with Steadman's extensive legal and financial experience 6/) that the banking relationships were of considerable moment to anyone trying to formulate rational decisions about the investment merits of the Steadman-managed funds. 7/

6/ Steadman was trained as a lawyer and practiced law for some years. The administrative law judge said in his initial decision that "Steadman, a lawyer, should have been particularly aware of the duties and responsibilities of a fiduciary."

7/ The administrative law judge's observations quoted in the preceding footnote about the effect that Steadman's legal knowledge should have had on his sensitivity to fiduciary duties applies a fortiori to the effect that his experience at the bar must have had on his awareness of the disclosure obligations that the federal securities laws impose on issuers and underwriters. Any lawyer whose involvement with financial matters is as intimate and

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Steadman had a self-interest in cultivating and mollifying the banks from which he

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(7 Continued)

> as long as Steadman's was knows how rigorous those obligations are. Moreover, Steadman must or at the very least should have realized that he could not find shelter from that rigor under the umbrella of privacy. Well before the first of the loans here in issue was made we had held in an unusually well-publicized stop order case that "We cannot agree ... that disclosure of Glickman's borrowings and pledges ... would have been an 'unwarranted revelation' of Glickman's personal affairs. An insider of a corporation that is asking the public for funds must, in return, relinquish various areas of privacy with respect to his financial affairs which impinge significantly upon the affairs of the company. That determination was made by the Congress over 30 years ago when it expressly provided in the Securities Act for disclosure of such matters as remuneration of insiders and the

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borrowed. That self-interest led him to keep unduly large sums unnecessarily idle in checking accounts to the banks' benefit but to the funds' detriment. Whether this actually happened or not is unimportant. The heart of the matter is that Steadman had disabled himself from looking at the funds' checking account balances in a wholly disinterested way, with an eye single to the funds' best interests. 8/

(7 Continued)

extent of their shareholdings in and the nature of their other material transactions with the company." Franchard Corporation, 42 S.E.C. 163, 174 (1964). To this passage a footnote citation (n. 29) to "Schedule A to the Securities Act, Paragraphs 14, 18-20, 24-25" was appended.

8/ The order for proceedings does not charge that the bank balances were excessive. Hence we do not find that they were. But we note that the balances were substantial. The unproductive balances in the New York bank at times exceeded $9 million.

Investors had a right to know this. So Steadman had a duty to reveal his collateral banking relationships, which were such that a reasonable investor or prospective investor could reasonably have drawn adverse inferences about the character of the funds' management. 9/

9/ As we said in Franchard Corporation, 42 S.E.C. 163, 169-170 (1964):

> "Of cardinal importance in any business is the quality of its management. Disclosures relevant to an evaluation of management are particularly pertinent where, as in this case, securities are sold largely on the personal reputation of a company's controlling person. The disclosures in these respects were materially deficient ....
>
> "Evaluation of the quality of management--to whatever extent it is possible--is an essential ingredient of

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Those interested in mutual fund investment have hundreds of funds to choose from.

(9 Continued)

> informed investment decision. A need so important cannot be ignored, and in a variety of ways the disclosure requirements of the Securities Act furnish factual information to fill this need .... To permit judgments whether the corporation's affairs are likely to be conducted in the interest of public shareholders, the registration requirements elicit information as to the interests of insiders which may conflict with their duty of loyalty to the corporation."

These observations are especially pertinent where purely financial institutions,

so-called financial intermediaries, are involved. See Clark, The Soundness of Financial Institutions, 86 Yale L. J. 1, 73 (1976): "Management ... integrity may be ... crucially relevant."

Thus they need data enabling them to make an informed assessment of the comparative merits of the products offered by a host of competing investment advisers. 10/

10/ Some think that a mutual fund is essentially the brand name under which an investment adviser sells its services to the public. See Lobell, Rights and Responsibilities in the Mutual Fund, 70 Yale L. J. 1258 (1961); Lobell, The Mutual Fund: A Structural Analysis, 47 Va. L. Rev. 181 (1961). Though we consider this so-called "shell theory" an incomplete guide to public policy (see our 1966 report to the Congress on the Public Policy Implications of Investment Company Growth (House Report No. 2337, 89th Cong., 2d Sess.) at pp. 75-76), it is by no means entirely fallacious. Indeed, it is

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Steadman's prospectuses and reports concealed important data of that kind. It follows that those prospectuses and those reports were materially deceptive. 11/

(10 Continued)

quite realistic. One who buys mutual fund shares is buying professional investment management. What could be more important to such a person than information that helps him appraise the extent to which a particular manager has enmeshed himself in conflicts of interest that competing managers have avoided? See Tannenbaum v. Zeller, 552 F.2d 402 (C.A. 2, 1977): "A mutual fund is a mere 'shell,' a pool of assets that belongs to the individual investors holding shares in the fund. The management of this asset pool is largely in the hands of an investment adviser, which generally originates the fund .... The adviser ... operates or supervises.

11/ Adequate prospectuses would not only have described the relationships, but called

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Accordingly, we find, as did the administrative law judge, that Steadman, SSC and

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(11 Continued)

> attention to the bearing that they might have on the funds' cash management policy. That is so because a Securities Act prospectus must make the essential facts clear to the ordinary investor. See Universal Camera Corporation, 19 S.E.C. 648, 652 (1945). This means that those facts must be presented in such form as to make their significance readily ascertainable." Franchard Corporation, 42 S.E.C. 163, 184 (1964). Proper prospectuses would have led at least some investors to take a critical look at the size of the funds' non-interest bearing bank balances, to wonder about the wisdom of paying sales loads (though the Steadman funds are now no-load, they were sold through dealers on a load basis during the relevant period) and management fees for the privilege of keeping substantial sums idle in checking accounts, and to consider other mutual funds that put their

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Republic, during the period from December 1965 to February 1972, willfully violated

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cash balances to productive use by placing them in treasury bills and other money market instruments.

Acceptable proxy-soliciting materials would have had the same effect. True, those materials were addressed to existing shareholders. And it is also true that given the realities of the power relationships in most mutual funds, it is improbable (though not impossible) that proper disclosure in the proxy-soliciting materials would have led to Steadman's ouster by a shareholder vote. Such things happen. But they happen rarely. What happens often, however, is a wave of shareholder redemptions evoked by widespread dissatisfaction. That would have mattered to Steadman. His organization's advisory fees, like those of most other investment advisors, were based on the amounts managed.

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and willfully aided and abetted violations of the antifraud provisions of the Securities, Securities Exchange, and Investment

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(11 Continued)

Secondly, adequate disclosure to the existing shareholders could have led some of them to institute derivative or class actions against the management. Such actions would have been predicated on the premise that the banking relationships were a breach of fiduciary duty. We need not and do not decide whether such actions (some of which are now pending, have been touched off, we surmise, by the initiation of these public proceedings) would have resulted in judgments for the plaintiffs. What matters for present purposes is that such cases could have been filed and that, if filed, they could scarcely be shrugged off as frivolous. One of the key aims of the disclosure provisions of the statutes we administer is to alert investors to facts indicating that they or their corporations may have valid claims against management

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Advisers Acts. 12/ We further find that Steadman and SSC willfully violated or willfully aided and abetted violations by others of the Investment Company Act's reporting and proxy-solicitation provisions. 13/

(11 Continued)

and to facilitate the prosecution of such causes of action. See Mutual Benefit Realty Fund, Securities Exchange Act Release No. 12195 (March 14, 1976), 9 SEC Docket 149, 151 n. 14. See also n. 25, infra.

12/ Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and Sections 206(1) and (2) of the Investment Advisers Act.

13/ With regard to proxy solicitations, Section 20(a) of the Investment Company Act and Rule 20a-1 thereunder prohibit any person from soliciting or permitting the use of his name to solicit any proxy with respect to any security issued by a

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Respondents maintain that the funds' bank accounts were wholly unrelated to the loans and

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(13 Continued)

registered investment company unless in compliance with not only Rules 20a-2 and 20a-3, but also all rules adopted pursuant to Section 14(a) of the Exchange Act. Rule 20a-3 requires the description of "any material proposed transactions, to which the investment adviser of the investment company or any ... subsidiary of the investment adviser was or is to be a party." And Rule 14a-9 under the Exchange Act makes it unlawful to solicit proxies with proxy materials which contain material misstatements or omissions, which is what the funds did. Similar prohibitions are contained in Section 34(b) of the Investment Company Act for reports filed or transmitted pursuant to that Act. And the funds' annual reports on Form N-1R and quarterly reports on Form N-1Q failed to make these material disclosures, as also required by Rules 30a-2 and 30b1-1 for reports filed pursuant to Section 30 of the Investment Company Act and Sections 13 and 15(d) of the Exchange Act.

the brokerage business that went to Steadman and his investment advisory organization. Taking vehement exception to the administrative law judge's finding that Steadman was continually bargaining for loans by holding out the funds' checking accounts as a quid pro quo, they contend that the record shows only a series of coincidences that involved one bank after another and that went on for year after year.

We need not and do not pass on the precise nature of the relationship between the funds' deposits and the benefits that Steadman obtained from the banks 14/ in which those deposits were kept. 15/

14/ Consequently, we need not pass upon respondents' contention that the administrative law judge improperly extracted from the documentary evidence statements showing that when the loans were sought, not only from the banks which granted them but from several which declined, references were made to the funds' deposits.

15/ But it is hard to believe that there was no link at all between the funds' deposits and

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Whether the banking relationships were or were not corrupt is beside the point for present purposes. What matters is that reasonable investors could reasonably have deemed those relationships "corrupting." 16/ And that is what brings the antifraud provisions to bear on the affair.

(15 Continued)

the benefits to Steadman. We note in this regard that save for one case in which special circumstances deprived Steadman of the power to disrupt a historic banking relationship that he had inherited from the fund's previous adviser, Steadman always saw to it that the funds kept their cash in banks that lent him money.

16/ Cf. Mr. Justice Jackson's opinion in Mosser v. Darrow, 341 U.S. 267, 271 (1961), where he spoke for the Court and observed: "Equity tolerates in bankruptcy trustees no interest adverse to the trust. That is not because such interests are always corrupt but because they are always corrupting."

Steadman himself may have believed that his actions were proper, and did the funds no harm. He also may not have planned to cause the funds to keep cash unnecessarily idle in checking accounts, rather than investing it for the funds' benefit.

But Steadman had a duty to disclose the facts that investors and their advisers needed in order to arrive at their own informed judgments about:

(A) The investment significance of his relationships with the banks in which the funds' cash was kept; and

(B) The implications of those relationships in assessing the quality and the integrity of his management.

We conclude that Steadman's long continued practice of borrowing heavily from the very same commercial banks in which he caused the funds to keep large sums on deposit had a potential for subordinating the funds' interests to Steadman's need for bank loans. Hence the subject was of sufficient moment to create "a substantial likelihood that a reasonable shareholder would consider it

important" in making his decision. 17/ Accordingly, we hold the undisclosed banking relationships "material."

The collateral banking relationships were among the intricacies attendant on an investment in a Steadman-managed fund. And the central purpose of the disclosure provisions of the securities statutes is to give investors "the means of understanding the intricacies of the transaction into which they are invited." 18/

It follows that Steadman was under a duty to bring the "complex of circumstances ... to [the

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17/ TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

18/ The quotation is from the House report on the bill that eventually became the Securities Act. H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933). And as we observed of this quotation in another case not long ago, "The thought illumines the Exchange Act as well." Multi-Benefit Realty Fund, Securities Exchange Act Release No. 12195 (March 11, 1976), 9 SEC Docket 149, 154 n. 26.

investor's] attention lucidly and forcefully." 19/

True, such breaches must be found "willful" before we can take cognizance of them in a proceeding of this character. But this does not mean that those subject to our administrative disciplinary jurisdiction can immunize themselves from its impact by substituting their own notions about disclosure for those adopted by the Congress and applied by the courts. 20/ As the Court of Appeals for the Second Circuit observed in Tager v. S.E.C. 21/ and again in Lipper v. S.E.C. 22/:

19/ Franchard Corporation, 42 S.E.C. 163, 181 (1964).

20/ See 2 Loss, Securities Regulation 1309 (2d ed. 1961); 5 id. 3368-3374 (1969 supp.).

21/ 344 F.2d 5 (1965), affirming our decision in Sidney Tager, 42 S.E.C. 132 (1964).

22/ 547 F.2d 171 (C.A. 2, 1976), affirming our decision in Arthur Lipper Corporation, Securities Exchange Act Release No. 11773 (October 24, 1975), 8 SEC Docket 273, but modifying the sanctions on the two respondents that appealed.

> "It has uniformly been held that 'willfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts." 23/

Respondents tell us that all this is now mere history. They say that the Supreme Court's decision of March 30, 1976, in Ernst & Ernst v. Hochfelder 24/ laid down a new rule under which no adverse findings can be made against them under any of the antifraud sections because there is no evidence that they intended to deceive. 25/

23/ 344 F.2d at 8, quoted with approval in 547 F.2d at 180.

24/ 425 U.S. 185.

25/ Our staff, on the other hand, maintains not only that intent to deceive is irrelevant, but that deception itself is irrelevant. In its view, the collateral banking relationships would have run afoul of the antifraud provisions even if disclosed. It

(Continued)

But Hochfelder was a private action for money damages. The plaintiffs were seeking to recover for negligent nonfeasance. Their allegations amounted at most to a claim that the defendant, an accounting firm that never made any representations to them and with whom they were never in privity, had carelessly aided and abetted someone else's violation of the securities laws. Thus the question presented was "whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of 'scienter' -- intent to deceive, manipulate or defraud." 26/ The Court concluded

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(25 Continued)

> reasons that there was so egregious a breach of fiduciary duty here that Steadman could no more cure his trafficking in the funds' deposits by making a clean breast of it than an embezzler can cure his embezzlement by disclosing it. The administrative law judge took this view. We eschew such speculations. Had the banking relationships been disclosed, an altogether different case would be presented. That case is not before us. And we do not decide it.

26/ 425 U.S. at 193.

that it could not. And since the plaintiffs "had proceeded on a theory of liability premised on negligence, specifically disclaiming that Ernst & Ernst had engaged in fraud or intentional misconduct," 27/ their complaint was dismissed. 28/

27/ Id. at 215.

28/ In their search for pecuniary redress, Ms. Hochfelder and her co-plaintiffs focused on a deep pocket at the outermost fringes of the scene. The plaintiffs conceded that they had not in fact relied on what the defendant did. Nor were the plaintiffs within the class to whom the defendant owed a common law duty of due care. 425 U.S. at 192, n. 9. Hence even in a private action founded solely on Rule 10b-5, the Hochfelder rule would not necessarily preclude a claim against someone like Steadman who far from being a peripheral actor was at the very center of a complex web of investment companies, investment advisers and principal underwriters, was a fiduciary for those investment companies and for their shareholders, was subject to

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The instant case does not resemble Hochfelder. This is not a private action for money damages. It is a proceeding initiated by a public authority for the prophylactic purpose of preventing future harm to the public interest. 29/ Nor

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(28 Continued)

affirmative disclosure duties imposed by federal statute, and who would even at common law have been deemed subject to a far higher standard of care than that incumbent on an ordinary businessman. See Hun v. Cary, 82 N.Y. 65 (1880); Medford Trust Co. v. McKnight, 292 Mass. 1, 197 N.E. 649 (1955). The Supreme Court's view seems in accord. Santa Fe Industries, Inc. v. Green, ___ U.S. ___, 97 S.Ct. 1292, 1299 n. 11 91977).

29/ Cf. n. 12 to the Hochfelder opinion: "Since this case concerns an action for damages, we need not consider whether scienter is a necessary element in an action for injunctive relief under § 10(b) and Rule 10b-5."

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does this case rest solely on Rule 10b-5. 30/ Indeed, it does not turn on 10b-5 at all. 31/

(29 Continued)

We are not unmindful of the Second Circuit's suggestion in Lipper v. S.E.C., 547 F.2d 171, 180-81 n. 6 (C.A. 2, 1976), that disciplinary proceedings may be more akin to actions for damages than to those for injunctive relief. But it did not decide "that the Hochfelder culpability standard applies in disciplinary proceedings." All that it did was to "assume, arguendo," that Hochfelder governs such proceedings. And, in any event, Lipper's formulation of willfulness (see 547 F.2d at 181) would be more than adequately met here.

30/ Section 17(a) of the Securities Act and the provisions of the Investment Company Act cited in n. 13, supra, are independent bases for liability.

31/ Section 17(a) of the Securities Act, which has been in effect since 1933,

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The references to that rule in the order for

(31 Continued)

makes it unlawful "(2) to obtain property by means of any untrue statement of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; (3) to engage in any transaction, practice or course of business which operates as a deceit upon the purchaser." In Hochfelder the Supreme Court pointed to the absence of similar language in Section 10(b) of the Securities Exchange Act, as distinguished from Rule 10b-5. The Court viewed this lack as a significant guide to 10b-5's scope. 425 U.S. at 214.

We note in this regard that a contemporaneous comment on Section 17 states that it "makes unlawful even innocent acts to obtain money or property by means of untrue statements of material facts or omissions to state material facts." Douglas and Bates, The Federal Secutities Act of 1933, 43 Yale

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proceedings and in this opinion are merely cumulative. 32/

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31 Continued/

L. J. 171, 181 (1933). See S.E.C. v. Van Horn, 371 F.2d 181, 185 (C.A. 7, 1966): "In view of the plain language employed by Congress, it would be presumptuous on our part to hold that the applicability of the clauses involved [Section 17(a)(2) and Section 17(a)(3) of the Securities Act] is dependent on intent to defraud." Hence Hochfelder has no bearing on cases brought under Section 17(a) of the Securities Act. S.E.C. v. World Radio Mission, Inc., 544 F.2d 535, 541 n. 10 (C.A. 1, 1976).

32/ Compare Crow, Brourman & Chatkin, Inc., 42 S.E.C. 938, 945 (1966): "[T]he violations found with respect to these provisions may be viewed as cumulative."

More could be said about our view of Hochfelder. But that is unnecessary. 33/ Respondents gain nothing from Hochfelder because the Hochfelder standard has been met.

What we have here is:

(1) a duty to reveal; plus

(2) an intent to conceal; and

(3) actual concealment.

This is not a "negligence" case. There was no accident, no monetary slip, no failure to act reasonably under stress. These were no ordinary commercial loans. They were large in amount and semi-permanent in duration. Borrowing from the banks in which his funds kept their cash was a way of life for Steadman. It was basic to his modus operandi. So he could scarcely have forgotten these banking relationships.

33/ However, we think it appropriate to note that we do not construe Hochfelder as altering the rule laid down in Hanly v. S.E.C., 415 F.2d 589, 597 (C.A. 2, 1969) that" ... proof of specific intent to defraud ... is irrelevant in broker-dealer proceedings."

Steadman did not choose to testify. Hence his state of mind must be inferred from the circumstances. 34/ And the pertinent circumstances are these:

(1) He concealed the loans from the funds' directors and did not disclose them to investors.

(2) He did so for many years.

(3) Though he claims to have relied on the advice of counsel with respect to other

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34/ That would probably be so even if he had testified. As we said in The Federal Corporation, 25 S.E.C. 227, 230 (1947):

> "Since it is impossible to probe into the depths of a man's mind, it is necessary in the usual case (that is, absent an admission) that the finding ... be based on inferences drawn from circumstantial evidence." Cf. Lawrence H. Ripp, Securities Exchange Act Release No. 13198 (January 24, 1977), 11 SEC Docket 1555, 1556.

matters, he makes no such claim with respect to his banking relationships. 35/

Accordingly, we find that Steadman and his corporate instrumentalities intended to deceive. Moreover, we agree with the respondents that intent is relevant here. That is so not because we consider intent pertinent to the willful violation issue, but because we deem it highly germane to determining the quantum of the remedial action, if any, that due regard for the public interest requires us to take.

Steadman's systematic, calculated and protracted concealment of his collateral banking relationships is enough in itself to brand him an unfit manager of other people's money. Even if there were nothing to this case but the undisclosed collateral banking relationships, we should be

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35/ Such reliance would not negate the willful violations. But it is often of great mitigative weight. Steadman is a lawyer himself. So he may have relied on his own view of what the law was. If he did that, he must have realized that he was going close to the line and assuming serious juridical risks.

constrained to bar Steadman from both the investment company and the investment advisory businesses.

III. THE BANKING RELATIONSHIPS -- REGULATORY ASPECTS

Our staff maintains that there is much more to the banking relationships than the mere failure to disclose them. 36/ It says that those relationships were flatly prohibited by the Investment Company Act. Three sections of that statute are invoked. They are:

(1) Section 15(a)(1) of the Investment Company Act, which makes it "unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which ... precisely describes all compensation to be paid thereunder" (emphasis added);

36/ We have already touched on one of its contentions in this area. See n. 25, supra.

(2) Section 17(d), which together with our Rule 17d-1 thereunder, requires that "joint participations" between investment companies and their affiliated persons be first scrutinized by us "for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than such other participant"; 37/ and

(3) Section 17(e)(1), which provides that "It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person--acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker." (Emphasis added.)

For Section 15(a)(1)'s purposes, the loans to Steadman and to SSC were "compensation"

37/ The quotation is from the statute.

to them. 38/ And the brokerage business that the banks gave Republic at Steadman's

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38/ Respondents argue that the loans were "standard commercial loans made at prevailing interest rates in accordance with standard banking practices." They contend that such loans are not "compensation" to the borrower. In support of their position they cite Imperial Financial Services, Inc., 42 S.E.C. 717, 728 n. 16 (1965). They say that the loans gave them nothing but the duty to repay them with interest.

We disagree. Loans are of economic benefit to those who receive them. Hence they are "compensation." Our 1965 Imperial decision is not to the contrary. All that the Commission held there was that a loan at 7% interest back in 1960 (when interest rates were low and 7% was an extremely generous rate) was a "less clear instance of the receipt of compensation" than another loan involved in that case which bore no interest at all. The Commission did not hold that the 7% loan was not "compensation." It

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instance was "compensation" to it, to its parent SSC, and to Steadman himself. 39/ But it does not follow that this was the type of compensation that had to be spelled out in the advisory contracts.

(38 Continued)

simply said, "[W]e make no finding with respect to this transaction." In our view that was simply a determination that it was unnecessary or inappropriate to reach the question on the record that the Commission had before it in Imperial (a case that was settled and in which the record consisted of a stipulation) and not as a holding that an interest-bearing loan can never be deemed "compensation."

39/ Respondents point out that the commissions "were earned in the course of ... business as a broker for the banks and ... paid for services actually rendered in executing ... purchase/sale transactions." We agree. But we do not see how that deprives those commissions of their compensatory character.

Section 15(a)(1)'s command goes only to the "compensation to be paid thereunder." The word "thereunder" is significant. We think that it means that the only compensation that counts for that purpose is compensation paid directly or indirectly by the investment company itself. When the authors of the Act wanted to reach "any compensation" "from any source," they said so. 40/

Accordingly, we hold that the Act did not mandate references to the collateral banking relationships in the advisory contracts. 41/

Section 17(d) and Rule 17d-1 thereunder present closer questions. Section 17(d) extends to "any transaction" in which a registered investment company "is a joint or a joint and several participant" with any of its affiliated persons, any affiliated person of such an affiliated person, any of its principal underwriters, or any

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40/ Section 17(e)(1).

41/ It does not follow that such references would have been improper or inappropriate. Their inclusion might well have been desirable.

affiliated person of any of its principal underwriters.

The key phrases in this subsection are "any transaction" and "a joint or a joint and several participant." The generality of this language, together with the paucity of judicial decisions construing it, has led to considerable uncertainty as to its exact scope. The parties' positions are far apart.

The Investment Company Institute would require that there be a joint venture between the investment company and the affiliate in pursuit of profit. This is too narrow a construction. Section 17(d) refers to a participant in a joint venture and to participation which is either "joint" or "joint and several." The joint venture concept is well known in the law. Had Congress intended to limit the reach of Section 17(d) to that concept, it would have said so.

As the Court of Appeals for the Second Circuit said in S.E.C. v. Talley Industries, Inc., 42/

42/ 399 F.2d 396 (1968), cert. denied, 393 U.S. 1015 (1969).

the leading case under Section 17(d) -- although not in point here on its facts:

> "[A]ny idea that § 17(d) is limited to the typical joint venture in which each of the parties has a fractional share is negated by the point that its very life is to limit or prevent participation by the investment company 'on a basis different from or less advantageous than that' of the affiliated person." 43/

The staff, on the other hand, would give Section 17(d) a very broad construction reaching most economic relationships in which an investment company is on one side and one of its affiliates is on the other. That would make a number of the Act's other provisions redundant. 44/ We are reluctant to adopt an interpretation so broad. That is so even though "transaction" is undoubtedly a broad term. As the Court of

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43/ 399 F.2d at 402.

44/ Sections 17(a) and 17(e) would probably be among those sections.

Appeals for the Second Circuit noted in Talley, "transaction" may mean "To prosecute negotiations; to carry on business; to have dealings ***." 45/

The concept of a "joint or joint and several" transaction is unusual. 46/ Applying the Talley principle that "some element of combination is required" 47/ but that a "loose kind of combination" may be sufficient on the basis of a liberal construction of the Act, 48/ three party

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45/ 399 F.2d at 402, quoting Webster's New International Dictionary (2d ed.) 2688.

46/ Resort to the law disctionaries is not overly helpful. According to Black's Law Dictionary (4th ed. 1968) and Ballantine's Law Dictionary (3rd ed. 1969), "several" means, essentially, "not joint." Joint and several is a procedural term, applicable primarily to contracts, and means in substance that a creditor acquires the option to sue his debtors individually or as a group.

47/ 399 F.2d at 403.

48/ Ibid.

transactions, such as those present here, would seem within Section 17(d)'s scope were there a causal connection between the funds' deposits and Steadman's loans. If the loans were a "quid pro quo" for the deposits, or the deposits a "quid pro quo" for the loans, the "combination" referred to in the Talley decision would be present. 49/ The funds would be "participants" because the use of their assets would have been so significant a part of the total transaction.

In the previous section we observed that "Steadman always saw to it that the funds kept their cash

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49/ This is not to imply that such a causal connection is necessary in every Section 17(d) case. It is necessary in the present case because without the participation of the banks there would be no joint transaction between the funds and Steadman. By way of contrast, for example, in the Talley case the joint transaction was the purchases of General Time Corporation shares by Talley Industries, Inc. and its affiliate, American Investors Fund, Inc. In that situation it was not necessary for the sellers of such shares to know that Talley and American Investors were in a joint transaction for there to be one.

in banks that lent him money" 50/ and that "this makes it hard to believe that there was no link at all between the funds' deposits and the benefits to Steadman." 51/ So it seems highly probable that the loans and the deposits were related to each other. 52/ Hence the administrative law judge inferred a causal connection. We find it hard to say that he erred when he did so. We have ourselves drawn comparable inferences 53/ in situations that seem analogous. 54/

50/ We noted that there was one exception, which involved a situation beyond Steadman's control.

51/ Note 15, supra.

52/ The contrary view leaves us with a most remarkable series of coincidences.

53/ See, e.g., C. Gilman Johnston, 42 S.E.C. 217, 219 (1964); Lawrence H. Ripp, Securities Exchange Act Release No. 13198 (January 24, 1977), 11 SEC Docket 1555, 1556.

54/ In this very case, we have already drawn one with respect to Steadman's state of mind. See text at n. 34, supra.

On this record, however, we are disinclined to infer the causality needed to bring Section 17(d) to bear on this situation. Much of the testimony is to the contrary. 55/

55/ Some of the bankers with whom Steadman dealt testified that in their minds there was no connection between the loans and the deposits. They claim to have viewed them as independent of each other. Their testimony is offset by papers that point to the opposite conclusion. However, the admissibility of those papers is challenged. So is their probative force. Finally, some of the very testimony on which the respondents rely can be read favorably to the Division. Some banker-witnesses distinguished the loans themselves from the interest rates that they bore. They insisted that the loans were unconnected to the deposits. But they conceded that balances on deposit normally affect interest rates. An important banker-witness characterized the determination of the interest rate as a "pricing decision" and testified that ample balances "would tend to lower the interest rate."

So questions of fact are raised. 56/ We do not reach them.

When the case is viewed as a whole, it becomes apparent that the causality issue is far from central. The issues we deem crucial relate to the respondents' duty to disclose. For reasons already stated, causality has no bearing on that. Hence we see no pressing need to resolve the factual questions on which the causality issue turns.

That precludes us from finding a causal nexus or a quid pro quo. Without this there is no basis for inferring a "combination." And absent some sort of "combination," however loose, adverse findings under Section 17(d) are unwarranted. Hence we make no such findings.

We come now to Section 17(e)(1). That prevented the respondents from accepting "from any source any compensation (other than a regular salary or wages ...) for the purchase or sale of any

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56/ With respect to the loans themselves, as distinguished from the interest rates that they bore, there is no live testimony that clearly supports the quid pro quo hypothesis.

property to or for" their investment company clients. If the loans and the brokerage business received from the banks were "compensation" to the recipients for purposes of Section 15(a)(1), 57/ they were also "compensation" to them for purposes of Section 17(e)(1). But (save for the certificate of deposit purchased from a Washington bank, 58/ which we put to one side for the moment), such "compensation" had no nexus with the purchase or sale of any investment company property.

That is obvious with respect to the brokerage commissions. They were generated by the banks' portfolio transactions. The investment companies' portfolios were uninvolved.

What of the checking account balances? Those were the funds' property. But that property was neither bought nor sold. Nothing was bought from the banks when deposits were made. Nor was anything sold to them when checks were

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57/ See note 38, supra.

58/ See text following note 4, supra.

written. What commercial banks sell to their demand depositors is services, not property. 59/

Certificates of deposit are different. They are not open book accounts but tangible choses in action. Banks sell them. And customers buy them. So the Steadman-managed fund that bought a 90-day certificate of deposit from a Washington bank purchased property from that bank.

However, it is not clear that the respondents received any illicit compensation for that purchase. It is true that Steadman owed this bank a large sum. And it is also true that his loan came due before the certificate was purchased. But the loan was extended before the certificate was purchased. The two transactions may well have been related to each other. But the record

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59/ Our staff argues that the funds' contractual rights to custodial services from the banks were "property." It also suggests that the custodial agreements involved the acquisition of space in the offices of the various banks for the safeguarding of securities and that the funds' interests in this space were their property. These contentions are ingenious but unpersuasive.

is not clear enough on this point to warrant an adverse finding. Accordingly, we find nothing in the banking phase of the case that violated Section 17(e)(1).

IV. ADVISORY FEES

The advisory agreements between SSC and two of the funds that it managed limited the advisory fee to 1% of the fund's average net assets. 60/ At the end of the fiscal year, it became apparent that the payments to SSC had exceeded that 1% maximum. 61/ So SSC owed the funds money. It

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60/ For a discussion of such limitations and their background, see Ellis, MutualFund Expense Limitations, 7 Review of Securities Regulation 932 (1974).

61/ In one case the year involved was the one that ended on June 30, 1970. In the other, the fiscal year closed on January 31, 1971. The overruns were caused by sharp declines in the value of the funds' assets. Those declines caused the aggregate advisory fee for the whole year to be appreciably lower than anticipated during the course of the year.

had a $155,000 obligation to one fund. And it owed the other $105,000.

SSC did not refund that $260,000 immediately. Instead it resorted to installments. These were paid monthly over time. Eventually, the entire $260,000 was returned to the funds with interest at 6% from the dates on which the funds' claims ripened.

The administrative law judge found that:

(A) SSC's duty to refund arose as soon as the year-end computations were made.

(B) SSC was unable or unwilling to discharge that duty promptly because it was in serious financial straits at the time.

(C) During the period that elapsed between the dates on which SSC became obligated to reimburse the funds and the date on which full reimbursement was finally made, SSC had the use of substantial sums that belonged to the funds.

These findings are clearly correct. And we adopt them as our own. The long and the short of the whole affair is that money that belonged to the funds and that they should have been

investing for their shareholders' benefit was in SSC's coffers and was used by SSC in its business.

Nothing in the advisory contracts between SSC and the two advisee-funds in question suggested that any benefits of this type would inure to SSC. In fact, such benefits did inure to SSC. It follows that:

(i) SSC received compensation from the two funds in question that, far from being described in the advisory contracts with the precision required by Section 15(a)(1) of the Investment Company Act, was left wholly unmentioned.

(ii) When it did that, SSC willfully violated Section 15(a)(1), which precludes "any person" from acting as investment adviser of a registered investment company pursuant to a contract that does not "precisely" describe "all compensation to be paid thereunder."

(iii) SSC's willful violations were willfully aided and abetted by Steadman himself, the prime mover in the whole affair. SSC's interest payments to the investment companies from which it obtained these extensions of credit do not

divest the transactions of their compensatory character.

The central fact is that SSC very much wanted to hold on to the money that it was supposed to return to the investment companies. The installment payment scheme originated with SSC, not with its investment company clients. We think it fairly clear that a debtor who is obligated to pay in full at once and who succeeds in inducing his creditor to accept a protracted installment schedule in lieu of the immediate full reimbursement to which the creditor is entitled reaps an economic benefit from the installment arrangement. Had SSC obtained the use of these monies without any interest at all, it would have received an outright gratuity from the investment companies. The interest payments gave the investment companies something of value in return for their forbearance. Nevertheless, that forbearance was of substantial economic benefit to SSC. Section 15(a)(1) required precise descriptions of such benefit in the advisory contracts. 62/

62/ The precise amounts of the advisory fee overpayments were, of course, unknown until the fiscal years in question had closed.

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Moreover, the 6% interest rate itself involved a detriment to the investment companies that received it and a correlative benefit to SSC. During the relevant period, the prime rate was in the neighborhood of 8%. 63/

So even if SSC's obligations had been of prime quality, it would have been getting a bargain rate of interest from its investment company clients.

(62 Continued)

Some months earlier, however, it became apparent that the year-end computations would probably show such overpayments. The record suggests that SSC realized at that early date that it would be inconvenient for it to pay in full at once. At that time it should have prepared the amendments to the advisory contracts that were needed in order to attain its objective. Those amendments should then have been submitted to special meetings of the affected investment companies' shareholders with appropriate disclosure.

63/ See Federal Reserve Bulletin, December 1970, pp. A-32, A-33.

Inherent in the statutory requirement that arrangements of this character be described in the advisory contracts with precision is the further requirement that they be accurately and adequately disclosed in the prospectuses of the affected investment companies and in their filings with us. The duty to make these disclosures was on Steadman and on his alter ego, SSC. Both of them breached that duty. 64/

We have not overlooked a controversy about the manner in which SSC computed its advisory fee. The administrative law judge found that the

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64/ We hold, as did the administrative law judge, that those breaches were in willful violation of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, Rule 10b-5 under the latter section, and Sections 206(1) and 206(2) of the Investment Advisers Act. We also affirm the administrative law judge's finding that Steadman and SSC willfully aided and abetted the affected funds' violations of Section 34(b) of the Investment Company Act, which makes it "unlawful for any person to make any untrue statement of a material fact in any ... document filed or transmitted pursuant to this title."

method of computation used inflated the fees. But the amounts involved appear immaterial. And the inflation was temporary.

V. TENDER SOLICITATION FEES

In 1969, tender offers were made for certain securities held by three Steadman funds. The offerors paid fees to soliciting brokers. Steadman had his broker-dealer alter ego, Republic, tender the funds' securities to the offerors, in return for which Republic received the solicitation fees. Those fees came to 2% of the value of the securities tendered. At first, Republic retained the entire 2%. Later, however, it decided that 2% was too much. So it gave half the fees to the tendering funds. The other half, i.e., 1% of the value of the securities, Republic kept. It reasoned that it was entitled to a 1% fee under Section 17(e)(2)(C) of the Investment Company Act, which permits a broker to collect a fee of up to 1% when "acting as broker" for an investment company with which he is affiliated. The question for decision is: Was Republic "acting as broker" in this situation?

The administrative law judge's answer was in Republic's favor. He thought that "Republic had

done the same things that an unaffiliated broker would have had to do had the task been assigned to it." Hence he found no violation of Section 17(e).

We cannot agree.

Where no brokerage is needed, no fee may be collected. These fees paid were to "soliciting brokers." Republic did no soliciting. It merely transmitted the tendered securities. No broker was needed for that. 65/

65/ Hence respondents' reliance on First Multifund of America, Inc., 44 S.E.C. 680 (1971), is misplaced. They are quite right when they say that the affiliated broker who was there permitted to retain brokerage compensation didn't work any harder than Republic did in this case. Neither case involved onerous chores. But the laboriousness of the task is not the test. Brokerage services may be and often are essentially clerical. Nevertheless, they may be needed. An affiliated broker who executes a registered investment company's order for 100 shares of American Telephone and Telegraph

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The decision to tender had already been made by the investment adviser. For making such

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(65 Continued)

> on the New York Stock Exchange does not have to strive mightily. Nevertheless, he is entitled to his commission. In First Multifund, a mutual fund was buying the shares of other mutual funds. The funds' shares, like those of Steadman's own funds during the relevant period, were sold only through independent broker-dealers. So anyone who wanted to buy those shares had to go to a broker. That is not so at all in the tender offer situation. No investor needs a broker in order to tender. The offeror is only too happy to take the securities directly from the holder. He saves money that way.
>
> When an investment company is involved and when that investment company has an affiliated broker, that saving for the offeror is a loss to the investment company. Hence we have pointed out that "directors and managers of investment companies ...

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decisions it received an advisory fee. It could not pocket a second fee for the very same service by donning its broker-dealer hat. 66/ Accordingly, we find that Republic, willfully aided and

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65 Continued/

may have an obligation to name an affiliated broker to receive ... solicitation fees." So the interposition of Republic was quite proper, indeed laudable. But Republic's retention of the fees was patently improper. As the release from which we have just quoted said, "commissions or fees on the tender of portfolio securities should not be retained by the affiliate but should inure to the benefit of the fund." Securities Exchange Act Release No. 10102, Withdrawal of Proposed Amendment to Rule 10b-13 under the Securities Exchange Act of 1934 (April 12, 1973), 1 SEC Docket No. 11, page 17.

66/ Provident Management Corporation, 44 S.E.C. 442, 449 (1970), a case on all fours with the instant case, held this practice "an impermissible form of personal

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abetted by Steadman, willfully violated Section 17(e) of the Investment Company Act.

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enrichment." Respondents and the Investment Company Institute answer that Provident is not a true precedent because the case was uncontested and because the opinion was written in connection with an offer of settlement. That contention does not go to the validity of Provident's reasoning. We think that reasoning valid. And we now reaffirm what we said there.

Moreover, we think that Provident has been a precedent since its publication back in 1970. An order that simply accepts an offer of settlement without comment does not create a precedent.

But Provident was not such a case. There we issued "an opinion stating our views on the issues raised. Such opinions [citations omitted] are written only after deliberation and analysis akin to that reflected in our opinions in contested cases. Hence

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VI. LATE FILINGS

The administrative law judge found that "[t]hroughout the period 1968 through mid-1972 the various Steadman affiliates, including the registered Steadman Funds advised by SSC, repeatedly failed to file required reports within the prescribed time. In many instances the reports were filed so late as to be of minimal value in serving the purposes intended by the requirements for filing the reports." 67/

Under the management agreements between Steadman's management company and the funds, SSC was obligated "to maintain the books of the Fund ... and to supervise the Fund's relations with its custodian, auditors and federal and state regulatory bodies." This included the filing of the funds'

(66 Continued)

they are as authoritative as opinions in those cases." Carl L. Shipley, Securities Exchange Act Release No. 10870, Investment Company Act Release No. 8394, Investment Advisers Act Release No. 419, p. 4 n. 6 (June 21, 1974), 4 SEC Docket 76, 479-480.

67/ No reports were filed during 1971.

annual reports. 68/ The annual reports of at least three funds were filed late for three consecutive years (1970, 1971, 1972). 69/ And the annual reports of Steadman's four broker-dealer firms 70/ were filed late in 1971 and 1972. 71/

68/ Section 30(a) of the Investment Company Act and Rules 30a-1 and 30a-2 thereunder require these reports.

69/ Reports were due in 1970, 1971 and 1972 for Fiduciary Fund and Aberdeen Fund on April 30 of each year, but their 1970 reports were not filed until September of that year, and those for 1971 and 1972 not until June 1972. American Fund's 1970 report, due May 31, was not filed until December, and its 1971 and 1972 reports not until June 1972. Similarly, Associated Fund's 1970 report, due January 28, was not filed until March 23, and its 1971 and 1972 reports not until June 1972.

70/ Section 17(a) of the Exchange Act and Rule 17a-5 thereunder require these reports.

71/ Reports for these firms were due on February 14 in 1971 and 1972, but were not filed until May 3, 1971 and June 19, 1972.

Respondents concede that the reports were late. 72/ They say, however, that those due in 1972 "were filed within a relatively short time after their due date," and that those due in 1973 "were all timely filed." These contentions do not go to the principal problem, the 1971 reports.

Those were more than a year late. Respondents seek to excuse these lengthy delays by pointing out that finding an adequate replacement for the funds' controller who resigned in 1971 took seven months; that the whole Steadman complex changed outside auditors during that year; and that requested extensions for the late broker-dealer filings were denied without explanation. These considerations in no way detract from the explicit requirements that reports be timely filed. The violations occurred. 73/

72/ No bookkeeping or recordkeeping violations are alleged.

73/ Hence Steadman willfully aided and abetted the funds' failure to file timely in violation of Section 30(a) of the Investment Company Act and

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Respondents' arguments seek to mitigate. But we find them unavailing.

Differing with respondents as to the cause of the delayed filings, the administrative law judge attributed them to Steadman's greater interest in expansion than attention to proper management of existing funds. 74/

(73 Continued)

Rules 30a-1 and 30a-2 thereunder. Moreover, the broker-dealers, willfully aided and abetted by Steadman, willfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder.

74/ He commented that "even when the need became painfully apparent, Steadman refused to expand SSC's managerial capability to manage properly the newly acquired Funds and the broker-dealers because the profitability of such acquisitions was predicated upon SSC's ability to manage the new Funds with little or no increase in SSC's personnel or other facilities."

He cited repeated advice given Steadman by his auditors that proper accounting functions were not being performed. 75/

And he cited a bank's termination of credit to Republic resulting from Republic's accounting problems.

SSC's personnel costs fell sharply in 1970. This suggests that Steadman was more concerned

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75/ It was these auditors who were replaced during 1971. But before that time they had advised Steadman that serious deficiencies existed in SSC's organization and capability to meet the increased responsibilities resulting from the expansion of the Steadman organization in 1967 and 1968. They pointed out that because of poor organization and inadequate personnel, daily accounting functions were not being performed, records were not being maintained, errors were going undetected, and report deadlines were being met with difficulty. They emphasized that this was a serious situation which might in the future require notice to regulatory agencies.

with keeping costs down than with maintaining the kind of an organization that was needed to do the job. Steadman chose to save money on essentials. The difficulties that this decision caused were self-created. So we do not see how those difficulties can possibly be deemed mitigative.

To file investment company annual reports more than a year after they were due is to flout basic regulatory requirements. Steadman's cavalier treatment of his reporting obligations frustrated the statutory design. We stressed the importance of these reports back in 1965 when we materially revised the form on which they are made. At that time we said:

> "[T]he data in both reports [an expanded public portion and a non-public section] will materially assist the Commission in its inspection program and will enable its inspectors to do their job more effectively and in a shorter time. In addition, the reports will serve the added purpose of laying before persons responsible for the management and operations of investment companies information which will

assist them to determine more readily whether the statutory standards and requirements are, in fact, being complied with, and thus in a measure achieve a substantial degree of self-inspection." 76/

76/ Investment Company Act Release No. 4151 (January 25, 1965), p. 2. See The Scholarship Club, Inc., 43 S.E.C. 917, 927 (1968), where we denied an exemption from another of the reporting requirements of Section 30 of the Investment Company Act because "Congress balanced the need for curing the evils resulting from the failure to give investors full information against the expense involved in reporting, and resolved the question in favor of requiring semi-annual reports." These same considerations apply here in the case of annual reports to the Commission. See also Prudential Insurance Company of America, 41 S.E.C. 335, 356 (1963), affirmed sub nom. Prudential Insurance Company of America v. S.E.C., 326 F.2d 383 (C.A. 3, 1963), certiorari denied, 377 U.S. 953.

The matter would be serious enough if we were dealing only with the respondents' failure to file their own reports. But there is much more to it than that. Many of the reports involved were due not from them but from their investment company clients. They were under fiduciary and contractual duties to those clients to file the reports on time. Hence the admitted late filings cannot be shrugged off as mere clerical slip-ups. Their egregious lateness has grave public interest implications.

VII. INTERCOMPANY TRANSACTIONS

During 1969 and 1970, Steadman Ameri-Fund, a foreign, unregistered investment company 77/ whose investment adviser was SSC, bought and sold securities directly from several registered investment companies for which

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77/ Steadman Ameri-Fund was a closed-end investment company formed under the law of the Netherlands Antilles. It grew out of an alliance between Steadman and five European banks. Those banks owned all of Ameri-Fund's stock.

SSC also served as investment adviser. 78/ Respondents assert that the administrative law judge erred in finding that those transactions violated Section 17(a) of the Investment Company Act.

Section 17(a) prohibits, absent an exemption, purchases of securities from or sales to a registered investment company by an affiliated person of such investment company, or by an affiliated person of such affiliated person. The question is whether Ameri-Fund was an affiliate of an affiliate of the registered funds.

Section 2(a)(3)(C) of the Act defines "an affiliated person" of another person to include "any person directly or indirectly

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78/ Ameri-Fund, which had no officers, was managed by an entity called Steadman International Capital Corporation ("Intercap"). Half of Intercap's shares were owned by SSC. The European banks owned the other half. Steadman was Intercap's president. More important, Intercap delegated the management of Ameri-Fund's portfolio to SSC. The governing documents gave SSC sole investment discretion.

controlling, controlled by, or under common control with, such other person." Moreover, an investment company's investment adviser is always an affiliated person of the advisee. 79/ Thus SSC, as adviser to both Ameri-Fund and the registered funds, was an affiliated person of each of them. But Ameri-Fund was not an affiliated person of the registered funds with which it dealt. However, if Ameri-Fund were directly or indirectly controlled by an affiliated person of the registered funds, viz. SSC, Ameri-Fund would have been an affiliated person of an affiliated person of the registered funds.

Respondents contend that SSC did not control Ameri-Fund. 80/ But Ameri-Fund was simply a portfolio of securities. To control that portfolio (and SSC had sole investment discretion with respect to it) was to

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79/ Section 2(a)(3)(E).

80/ Section 2(a)(9) of the Act defines "control" as "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

control Ameri-Fund. 81/ Hence SSC controlled Ameri-Fund. That made Ameri-Fund an affiliated person of an affiliated person of the

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81/ Respondents' contentions to the contrary rest in large measure on the patently predominant position of the European banks that owned all of Ameri-Fund's stock. That they had ultimate control is plain. When dissatisfied with Steadman, they ousted him. But that did not happen until after the close of the relevant period. During that period Steadman was running Ameri-Fund. So he had the power to exercise a controlling influence over the management or policies that Section 2(a)(9) equates with "control."

Respondents point out that when a person's controlling influence "is solely [emphasis added] the result of an official position with such company" (Section 2(a)(9)), he is not deemed to control it. This does not aid them. That exclusion applies to officers and directors because officerships and directorships are official positions. An investment adviser, on the other hand, holds no "official position" by

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registered companies. It follows that Section 17(a) prohibited the swapping of

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(81 Continued)

> virtue of his advisership. He is an independent contractor. Moreover, the term "investment adviser" is to some extent a misnomer. It is a time-honored misnomer enshrined in the Act which borrowed its vocabulary from that of the pre-1940 investment company industry. The so-called "adviser" is no mere consultant. He is the fund's manager. See page 46 of our 1966 report on the Public Policy Implications of Investment Company Growth. House Report No. 2337, 89th Cong., 2d Sess. Hence the investment adviser almost always controls the fund. Only in the very rare case where the adviser's role is simply that of advising others who may or may not elect to be guided by his advice (and there is no contention that this was Ameri-Fund's situation) can the adviser realistically be deemed not in control.

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securities between Ameri-Fund and the registered domestic companies. 82/

(81 Continued)

Hence we find no substance to the respondents' argument that no adverse finding can be made because of the sentence in Section 2(a)(9), which reads: "Any person who does not ... own more than 25 per centum of the voting securities of any company shall be presumed not to control such company." That presumption is rebuttable. And an investment advisership is normally enough in itself to rebut it. The adviser's controlling influence over his advisee does not stem from stock ownership. It stems from the fact that he manages the fund's affairs and that his is normally the only audible voice in day-to-day management.

82/ Respondents have moved that all allegations regarding transactions with Ameri-Fund be dismissed because we earlier accepted offers of settlement from that fund and from Intercap.

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We are therefore constrained to find that SSC and Steadman willfully aided and abetted

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Thus, they argue, we prejudged the issues with respect to them. This contention is without merit. The order accepting the offers of settlement expressly stated that "[t]he findings herein are not binding upon any other respondent named in the proceedings." Investment Company Act Release No. 7378 (September 22, 1972). And our press release also stated that our findings were based on offers of settlement. No prejudgment occurs when prior findings against another respondent are based on that respondent's offer of settlement. See Atlantic Equities Company, 43 S.E.C. 354, 366 (1967), aff'd sub nom. Hansen v. S.E.C., 396 F.2d 694 (C.A.D.C.), cert. den., 393 U.S. 847 (1968). Moreover, the Administrative Procedure Act exempts the members of the Commission from the separation of functions requirement applicable to our staff.

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violations of that section in each of the twelve instances in which they caused the domestic companies to buy securities from or sell them to Ameri-Fund. 83/

Had Ameri-Fund been registered under the Act, these transactions would have been perfectly lawful. That is so because of our Rule 17a-7 under Section 17(a), which exempts most intra-complex swaps from the sweep of the statutory prohibition. Rule 17a-7 was adopted "to serve the interests of investors by permitting

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5 U.S.C. §5554. This permits us to consider a matter in our administrative capacity and thereafter render a decision with respect to it in our quasi-judicial capacity. See Attorney General's Manual on the Administrative Procedure Act (1947), p. 58. Finally, as stated above, our decision here is based solely on the record now before us.

83/ As noted earlier, Steadman was chairman of SSC's board of directors and owner of all its voting stock. So SSC's decisions were Steadman's decisions.

affiliated registered investment companies, which previously may have purchased or sold securities on the open market in order to avoid the application procedures of Section 17(b) and thereby incurred duplicate brokerage charges, to effect such transactions with each other and pay no charges." 84/ Since Ameri-Fund was not registered, these transactions required an exemptive order from us. We do not condone the failure to seek such order 85/ or

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84/ 33 S.E.C. Ann. Rep. 117 (1967).

85/ That failure is said to have been based on the advice of counsel. But no showing has been made that counsel were ever asked to opine on this point. They were consulted about other legal problems presented by the Ameri-Fund venture. Thus, for example, they advised Steadman that Ameri-Fund did not have to register under either the Investment Company Act or the Securities Act. That advice appears to have been correct. But it had no bearing on Section 17's reach.

orders. 86/ But realism requires us to take account of the following factors:

(1) The rationale of Rule 17a-7 applies to these transactions. Each of them could have been effected with perfect legality in the open market through a broker. Had that been done, the net effect on investors would have been the same as it was. But substantial brokerage commissions would have been expended.

(2) No showing has been made that any of the companies involved was harmed.

These violations were somewhat technical. Hence they are of little weight in assessing sanctions.

86/ We think that such applications would have been granted. And we do not believe that a succession of applications would have been needed. Steadman could have sought an order exempting the entire class of transactions. Such orders are frequent under the Investment Company Act.

VIII. THE PUBLIC INTEREST

A. Introduction

The administrative law judge described the case as "novel and complex." That is true of many areas. But those are peripheral.

The central areas are deceit and reckless disregard of applicable filing requirements. Both have long been known. 87/ Both are

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87/ Respondents make much of the fact that no previous litigated case to come before us involved collateral banking relationships of this type. (We have had other cases in that general area. But all of them were settled.) That does not seem especially significant. All that is involved here is the duty to tell the truth. That the particular context in which that duty was breached was never dealt with in an earlier case is of little, if any, moment. Suppose, for example, that another case about investment company banks accounts comes up next year. Suppose that, in that one, the investment

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simple. And both are extremely serious. We agree with the administrative law judge that "Strong sanctions are required to protect the public interest." 88/

(87 Continued)

adviser simply wrote himself a check for all the money in the investment company's bank account. Would he be heard to argue that a remedial proceeding based on his failure to make appropriate disclosures is a juridical novelty and that this absence of relevant precedent requires that sanctions be softened or withheld altogether?

88/ This seems as good a place as any to deal with the respondents' vitriolic attacks on the administrative judge. Those seem baseless to us. They say, for example, that his "opinion ... is but a duplicate of the briefs submitted by the Division of Enforcement." But the administrative judge found against the Division on a number of points. True, he happened to agree with the Division on the basic things. That, however, scarcely brands

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They are needed for two reasons. The first is that our governing statutes are drawn on

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him an unfit judicial officer. Though our views diverge from those of the administrative judge at a number of points, we find his conduct of the case unexceptionable.

Nor can we agree that the administrative judge applied an erroneous standard of proof. He guided himself by the "preponderance of the evidence" standard. Respondents say that the "clear and convincing" standard controls. We think that the administrative law judge was right. Hence we reaffirm our prior holdings that in remedial proceedings of this character a preponderance of the evidence is sufficient to establish the truth of an allegation. Norman Pollisky, 43 S.E.C. 458, 459-460 (1967); Underhill Securities Corporation, 42 S.E.C. 689, 695 (1965); White and Weld, 3 S.E.C. 466, 539-540 (1938). These are not criminal proceedings. Even if we were seeking to

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the premise that past misconduct gives rise to an inference of probable future misconduct. When the misconduct is as egregious as it is in this case, we must take effective measures to protect investors and the public interest from future harm at the wrongdoers' hands.

The second factor that leads us to agree with the administrative law judge's assessment of the quantum of remedial action that the public interest demands is the impact that the decision is likely to have on the welfare of investors as a class and on the ethical climate of the walks of life that we regulate. Leniency in a case of this character is bound to encourage irresponsibility, cavalier attitudes toward basic disclosure

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discipline a lawyer, the preponderance of the evidence standard would govern. Charlton v. F.T.C., 543 F.2d 903 (C.A.D.C., 1976). In any event, this burden of proof controversy is now pointless. Our opinion is based on the undisputed facts and on the inferences that we have drawn from them.

obligations, and disregard for inconvenient filing requirements. That cannot be done. As the Court of Appeals for the Second Circuit recently noted: "The purpose of sanctions must be to demonstrate not only to petitioner but to others that the Commission will deal harshly with egregious cases." 89/

B. Steadman's Case

So egregiously faithless a fiduciary as Steadman 90/ cannot be permitted to meddle

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89/ Lipper v. S.E.C., 547 F.2d 171 (C.A. 2, 1976).

90/ Our conclusion that Steadman has shown himself a faithless fiduciary is based not on the banking relationships themselves (see n. 25, supra), but on:

(1) Steadman's intentional and protracted concealment of those relationships from the funds' actual and prospective shareholders, from the funds' independent directors, and from this Commission; (compare Santa Fe Industries, Inc. v. Green, ____ U.S. ____, 97 S.Ct. 1292, 1299 (1977)); and

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(2) His causing his corporate instrumentalities to commit flagrant and intentional breaches of their contractual and fiduciary duties to see to it that the funds complied strictly with their reporting obligations to us--obligations that Steadman's instrumentalities had undertaken to perform for the funds and which, as Steadman well knew, the funds were wholly incapable of performing for themselves.

The boundaries of the fiduciary concept are necessarily hazy. Much often depends on the particular factual setting and on the precise questions presented. But some things are axiomatic. It seems to us that among those axioms is the proposition that federal statutes of general application are at least as binding on fiduciaries as they are on other people. It follows that when a fiduciary breaks laws enacted for the benefit of his cestuis que trust, he breaches his fiduciary duties to them. And that is exactly what Steadman did. Accordingly,

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further with other people's money. 91/ Hence we agree with the administrative

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> we think it much too clear for argument that he engaged in acts and practices "constituting a breach of fiduciary duty involving personal misconduct in respect of [a] registered investment company" within the meaning of that phrase as used in Section 36(a) of the Investment Company Act.

91/ We would reach the same conclusion if the Investment Company Act said nothing about "a breach of fiduciary duty involving personal misconduct." In fact, however, Section 36(a) of the Investment Company Act not only stigmatizes such breaches, but authorizes the courts to enjoin persons who have committed them or who are about to commit them from further association with registered investment companies. Now it is quite true that, as Carl L. Shipley, Securities Exchange Act Release No. 10870, Investment Company Act Release

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law judge that Steadman must be excluded from both the investment company business and the

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No. 8394, Investment Advisers Act Release No. 419 (June 20, 1974), 4 SEC Docket 476, 478, pointed out, Section 36 "simply authorizes the Commission to file an action in the Federal court and empowers the court to grant appropriate relief." Hence Shipley held that "Section 36 cannot serve as the sole [emphasis added] basis for administrative sanctions."

But Shipley also explained that:

> "Our conclusion that we cannot conduct an administrative disciplinary proceeding based solely upon an alleged violation of Section 36 does not mean that we have no authority to take cognizance of that section in a proceeding otherwise appropriately before us. [And this is such a

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investment advisory profession generally. Like the one from which the respondents appealed, our order will:

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> proceeding.] Section 36(a) has been held to be more than a mere grant to the federal courts of jurisdiction to apply common law principles. It is also a means of enforcing the Investment Company Act. [At this point a footnote (n. 15 reprinted at p. 480 of 4 SEC Docket) cited and quoted from Brown v. Bullock, 194 F. Supp. 207, 238 (S.D.N.Y. 1961), affirmed on other grounds, 294 F.2d 415 (C.A. 2, 1961).] Consequently, ... in an administrative proceeding where we had found willful violations of some other provisions of the Act, we could, on the issue of what sanction was appropriate, consider and

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(A) Permanently prohibit Steadman from associating himself with any registered

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> determine whether or not the respondent had committed a breach of trust involving personal misconduct within the meaning of Section 36."

For reasons developed in the foregoing extract from our Shipley opinion, we have the power, and indeed the duty, to take the status of Steadman's conduct under Section 36 of the Investment Company Act into account when we assess the sanction here. Steadman suggests that this is unfair to him because the order for proceedings gave him no notice that fiduciary duty would be an element in the case. The claim is frivolous. Section 36 has no substantive significance here. It goes only to the question of sanction. And on that question the range of pertinent considerations is almost infinite.

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investment company or any investment adviser to, depositor of, or principal underwriter

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See International Shareholders Services Corporation, Securities Exchange Act Release No. 12389A (June 8, 1976), 9 SEC Docket 821, 825-826 n. 19: "Assessing the nature of the remedial action that the public interest calls for under the concrete circumstances of a particular case is a serious and an onerous task. Many factors (some of them more easily felt than articulated) are worthy of consideration .... The range of inquiry is broad."

Even in a criminal case, which this is not, a defendant would be altogether unable to make anything out of the fact that the indictment failed to give him notice of each and every circumstance that the court might possibly take into account on sentencing.

Though these proceedings are not criminal, they are intensely serious.

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for any such company in any of the capacities specified in Section 9(b) of the Investment Company Act; 92/

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And we take them very seriously indeed. But since counsel have had opportunity to argue the sanction questions and have in fact argued them at great length, we see no unfairness here.

92/ Section 9(b) reads in pertinent part:

> "The Commission may ... prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an adisory board, investment adviser or depositor

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(B) Bar him from association with any

(92 Continued)

> of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor or principal underwriter if such person-- ... (2) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of title II of this Act [the Investment Advisers Act], or of this title, or of any rule or regulation under any of such statutes."

Section 9(b)(3) confers a like power on us with respect to any person who "has willfully aided, abetted, counseled, commanded, induced or procured the violation by any other person of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of title II of this Act, or of this title, or of any rule or regulation under any of such statutes."

investment adviser; 93/ and

(C) Suspend him for one year from association with any broker or dealer.

93/ Steadman questions our power to do this. He raises a comparable question about the reach of Section 9(b) of the Investment Company Act, quoted in the preceding footnote. The two arguments rest on a single foundation. Hence we treat them together.

Steadman correctly points out that before the Investment Company Amendments Act of 1970 (84 Stat. 1413, et seq.) neither the Investment Company Act nor the Investment Advisers Act empowered us to take the action that we now propose to take with respect to him under the post-1970 versions of those statutes. The pre-1970 version of the Investment Company Act made no provision at all for administrative remedies. Our 1966 Public Policy report noted (at pp. 338-340) that this was an anomaly and urged a curative amendment along the lines of present Section 9(b).

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The administrative law judge explained that he was imposing "less severe sanctions ...

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> The Investment Advisers Act presented a somewhat similar situation. Though that statute authorized administrative proceedings ever since it was first enacted in 1940, those proceedings prior to 1970 related to firms rather than to people. We had no administrative power to bar anyone from association with an investment adviser. Nor could we suspend or limit such associations. That was a significant shortcoming. Congress rectified it. It did so by amending the Advisers Act. (The Investment Company and Investment Advisers Acts are intimately related. Indeed, the two were enacted together as Title I and Title II of the same bill. 54 Stat. 789 (1940). So the Congress addressed itself to both statutes in the Amendments Act of 1970.) The pertinent change in the Advisers Act was the addition of present Section 203(f). 84 Stat.

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against Steadman under the Exchange Act than the maximum sanctions imposed upon him

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93 Continued/

1432. That empowered us to proceed against persons under the Advisers Act just as we had been doing under the Exchange Act ever since 1964 when the Securities Amendments Act of that year revised Section 15(b) of the 1934 statute.

The amendments that we have just described became effective on December 14, 1970. Steadman reasons that this means that no sanctions can be imposed under either Section 9(b) of the Investment Company Act or Section 203(f) of the Investment Advisers Act for anything that happened before December 14, 1970. For the moment we assume, arguendo, that he is right about that. The result is unaffected. The order that initiated these proceedings issued on June 23, 1971, more than six months after the effective date of the 1970 amendments. And much of the alleged

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under the I.C.A. and the Advisers Acts because the violations under the last two

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misconduct occurred after the amendments had become law. Thus, for example, the failures to file reports when due relate to the years 1971 and 1972. With respect to those, Steadman gains nothing from historical references to the pre-December 14, 1970 deficiencies in our catalogue of remedies. Nor do those references aid him on the fraud issues, the very heart of the case. His concealments were continuing wrongs. They did not stop on December 14, 1970. They went on far beyond that date.

Moreover, Steadman's premise is erroneous. He relies on the constitutional ban on ex post facto laws. U.S. CONST. art. I, § 9, cl. 3: "No ... ex post facto law shall be passed." But this clause applies only to retroactive penal legislation. Calder v. Bull, 3 Dall.

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Acts are deemed more significant in terms of the need for long-range protection of the public interest." But the heart of this case is deception. And that deception was calculated and protracted. Such a propensity to deceive is as unsuitable in a broker or dealer as it is in an investment

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93 Continued/

386 (1798). Hence, it interposes no bar to the retrospective application of tests of fitness in licensing statutes. Hawker v. New York, 170 U.S. 189 (1898). Moreover, Sections 9(b) and 203(f) effected no substantive changes. They had no effect on the substantive legality of the conduct here involved. The concealments were made illegal back in 1933. And the filing duties involved date back to the early years of the Exchange and Investment Company Acts. The changes that went into effect on December 14, 1970, went solely to matters of remedy and had no bearing on legal rights or legal duties.

adviser or in an investment company manager. 94/

When shall the sanctions take effect? Where we have found the misconduct serious enough to warrant a bar, the bar order normally becomes effective on issuance. 95/ That seems inappropriate here.

Steadman is the active operating head of the management organization. To oust him

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94/ Cf. Thomas E. Jackson, Securities Exchange Act Release No. 11476 (June 16, 1975), 7 SEC Docket 193, 194: "Although Jackson's wrongdoing in this instance did not involve securities, the NASD could justifiably conclude that on another occasion it might."

95/ But when barred or revoked respondents appeal or indicate that they intend to appeal to the Court of Appeals, we give stays of sufficient duration to enable them to seek further stays from the courts. See Nassar & Company, Inc., Securities Exchange Act Release No. 13081 (December 17, 1976), 11 SEC Docket 1221, 1222; Arleen W. Hughes, 27 S.E.C. 952, 956 (1948).

at once might leave the funds in difficult straits, albeit temporarily. We think it better to permit him to remain on board for 90 days. That should give the funds' directors adequate opportunity to make appropriate arrangements for their beneficiaries' post-Steadman future.

Another factor that leads us to deem a 90-day stay appropriate is our wish to be fair to Steadman himself. His SSC stock may well be of substantial economic value. We see no need to divest him of that value. The 90-day transitional period gives him abundant time to find a buyer.

C. The Corporate Respondents

Stating that he saw no reason to visit Steadman's sins and those of SSC on their co-respondents, the administrative law judge tried to assess the precise culpability of each corporate respondent. He first found SSC guilty of grave wrongdoing. He then predicated his conclusions with respect to the four SSC subsidiaries before him on "the number, nature and gravity of violations committed by each particular respondent." Normally, we should commend that course. Every effort should be made in proceedings of this character to steer clear of even a hint of guilt by association.

But such efforts must be tempered by realism. The corporate respondents in this case are all Steadman's instrumentalities. That one of them happened to transgress more than another was mere accident. It suited Steadman to do things that way.

The administrative law judge thought that SSC should be put out of business. Were we to agree with him about that, we should conclude that SSC's wholly owned subsidiaries deserve the same fate. But we see no pressing need for any sanctions at all on either SSC or its children.

It is the real parent, not SSC but Steadman himself, at whom the remedy must be aimed. His corporate children can safely be left alive for adoption by others, just as Steadman himself in days gone by acquired advisory and broker-dealer entities from people unaffiliated with him. Were this the usual one-man corporation case, the result would be different. There no one has any real interest in the corporation other than its sole controlling person. Hence sanctions on him are normally coupled with correlative sanctions on his corporate alter ego.

Two factors appear to make this approach inappropriate here. One is SSC's nature and function. The SSC organization manages what is still a fairly substantial investment company complex. Were that organization to be liberated from Steadman's influence and were control over it to pass to clean hands, the continued existence of the SSC organization would be perfectly compatible with the public interest. 96/

96/ Compare Arthur Lipper Corporation, Securities Exchange Act Release No. 11773 (October 24, 1975), 8 SEC Docket 273, 281 (1975), modified on an appeal by other respondents sub nom. Lipper v. S.E.C., 547 F.2d 171 (C.A. 2, 1976): "IPC's case differs materially from IOS's. IPC was a mere instrumentality. It was never an independent actor. Moreover, its present owners are wholly unaffiliated with IOS. It follows that a sanction against IPC could not possibly tend to achieve any remedial purpose. We therefore find it in the public interest to discontinue the proceedings, so far as they relate to IPC."

Secondly, we cannot ignore SSC's non-voting shareholders. 97/ To revoke the corporate respondents' registrations with us would be to strip them of the going concern value (actual and potential) of their interest. There is no compelling public interest reason to do that.

Finally, the imposition of sanctions on the corporate respondents at this time would be inconsistent with our decision to give Steadman a reasonable time within which to dispose of his SSC stock, if he can. Were we to put SSC out of business now, Steadman would be left with nothing to sell.

If Steadman had already sold out to a responsible and competent successor, we should dismiss here and now as against all of the corporate respondents. 98/ But

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97/ Some of them may be public investors.

98/ We should also grant the applications of three of them (Steadman Investment Services Corporation, Aberdeen Management Corporation, and Republic Securities Corporation) for the withdrawal of their registrations as brokers

(Continued)

there is no assurance that such a successor will appear. So dismissal at this time would be patently premature.

Having given Steadman 90 days to find a buyer, we now give SSC that same 90 days to liberate itself from his influence. If an adequate showing is made within those 90 days that all links between SSC and Steadman have in fact been severed and that SSC is in new and responsible hands, we shall dismiss as to it and its subsidiaries. SSC's failure to make such a showing will necessitate a reassessment of the situation at the end of the 90-day period. Hence the order we enter this day will reserve jurisdiction over the corporate respondents.

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98 Continued/

and dealers. In view of the position taken in the text and in the Lipper case cited supra, we should be constrained to find that the tests set forth in our Rule 15b6-1(b) under the Exchange Act had been satisfied.

IX. CONCLUSION 99/

Our order will:

(A) Bar Steadman from association with any investment adviser;

(B) Prohibit him permanently 100/ from serving or acting as an employee, officer,

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99/ Some of the many contentions made have not been treated explicitly. This does not mean that we have ignored them. All points presented have been carefully considered.

100/ The word "permanently" is taken from Section 9(b) of the Investment Company Act. However, we always retain control over our own orders. Inherent in the power to issue orders of this type is the power to modify them. Hence "permanently" in this context really means "indefinitely." The bar from association with any investment adviser is also of indefinite duration. See Applications for Relief from Disqualification, Securities Exchange Act Release

(Continued)

director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;

(C) Suspend him for one year from association with any broker or dealer;

(D) Stay the effective date of the aforementioned sanctions for 90 days from the date hereof, thus:

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100 Continued/

No. 11267, Investment Company Act Release No. 8689, Investment Advisers Act Release No. 438 (February 26, 1975), 6 SEC Docket 346. Judicial notice has been taken of our discretionary power to lift or modify disqualifications. The authorities are collected in John R. Brick, Securities Exchange Act Release No. 11763, Investment Advisers Act Release No. 483 (October 24, 1975), 8 SEC Docket 240, 247-248 n. 38, where we stated that "so-called lifetime bars are actually bars of indefinite duration."

(i) facilitating an orderly transition to new management wholly divorced from Steadman's influence; and

(ii) giving Steadman himself an adequate opportunity to dispose of his SSC stock;

(E) Require SSC to file a report with us about what, if anything, has been done to sever Steadman's links to it; 101/

(F) Reserve jurisdiction to enter such other, further, and different orders with respect to the corporate respondents as we in our discretion may hereafter deem appropriate in the public interest and for the protection of investors in light of the contents of the aforementioned report--or

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101/ This report shall be filed within 90 days from the date hereof and shall be accompanied by proof of service on our Division of Enforcement and on our Washington Regional Office.

if no such report should be filed, in light of the failure to file it. 102/

By the Commission (Chairman WILLIAMS and Commissioners LOOMIS and EVANS); Commissioner POLLACK not participating.

George A. Fitzsimmons
Secretary

102/ Respondents' objections to the initial decision are overruled or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 13695 / June 29, 1977

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 593 / June 29, 1977

INVESTMENT COMPANY ACT OF 1940
Rel. No. 9830 / June 29, 1977

Admin. Proc. File No. 3-3101

In the Matter of

STEADMAN SECURITY CORPORATION
1730 K Street, N.W.
Washington, D. C.
(801-8141)

CHARLES W. STEADMAN

REPUBLIC SECURITIES CORPORATION
(8-13223)

STEADMAN INVESTMENT SERVICES CORPORATION
(8-14704 and 801-5679)

THE STEADMAN CORPORATION OF AMERICA
(8-13955)

ABERDEEN MANAGEMENT CORPORATION
(8-1867)

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Charles W. Steadman be, and he hereby is,

(1) Barred from association with any investment adviser;

(2) Permanently prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

(3) Suspended for one year from association with any broker or dealer; and it is further

ORDERED that the above sanctions shall become effective at the opening of business on October 3, 1977; and it is further

ORDERED that Steadman Security Corporation be, and it hereby is, directed to file twelve copies of a report with the Secretary of the Commission (to be accompanied by proof of service on the Commission's Division of Enforcement and on its Washington Regional Office) setting forth in detail the steps, if any, that have been taken to sever Steadman's links to

it; and it is further ORDERED that Steadman Security Corporation file the aforementioned report on or before October 3, 1977; and it is further

ORDERED that jurisdiction be, and it hereby is, reserved with respect to all of the corporate respondents herein to enter such other, further, and different orders as the Commission may in its discretion deem appropriate in the public interest and for the protection of investors in light of the contents of the aforementioned report--or if no such report should be filed, in light of the failure to file it.

By the Commission.

George A. Fitzsimmons
Secretary